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AMERICAN CENTURY FUNDS LUNCHEON
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Thank you, Bill *[Lyons]* for that kind introduction. And I want to thank American Century for inviting me to this luncheon.

As you know, we originally were scheduled to meet last September, but this luncheon was cancelled because of the September 11th attack. Although next week marks 7 months since September 11, I know that we all still feel its reverberations – especially those of us in the financial services industry. It was our colleagues and competitors who worked in those towers. Wherever we may live, our lives are interlocked with Lower Manhattan.

The terrorists who attacked us wanted to disrupt our economy and our way of life. The fact that we are still meeting today -- that business as usual, or as usual as it can be, continues – is a testament to our resolve. I thank you for being here.

[pause]

We meet today after the passing of a historic moment in the history of the capital markets. One of the largest companies in the nation has collapsed under the weight of its multi-layered, inter-connected corporate structure -- a structure supported by creative accounting. Its collapse has touched hundreds of thousands of investors. The political world is embarrassed by the loss of such a large campaign contributor. Newspapers have called it, "the biggest business failure in the history of the world."

And this historic moment happened in 1931 – more than 70 years ago. The company was Insull Utility Investments, founded by Samuel Insull, the one-time private secretary to Thomas Edison.

The historian Ron Chernow said that after the collapse of Insull's I.U.I., "People felt so swindled they never went near the market again. There was a lost generation of investors."

The challenge facing all of us involved in the capital markets today is to make sure that the generation living in the wake of Enron does not become a <u>second</u> generation of lost investors. And that is what I want to talk about with you this afternoon: how we can restore confidence in the financial system and keep our markets vibrant.

It is clear that there is a crisis of systemic confidence in our markets – a crisis that threatens the markets so vital to this country's economic health. More than half of all adult Americans now own stock so the impact of the Enron fiasco and the end of the bull market is wide – and apparently deep. A recent poll found that 68 percent have little or no faith that the stock market treats average investors fairly.

We have an opportunity – and a duty -- to repair the trust in those on whom investors depend, and in the process, trust in the numbers that are the backbone of our capital markets. But our response must be comprehensive. Healthy and resilient financial markets depend on the transparency and accountability of every one of its key actors – managers, auditors, directors, analysts, lawyers, rating agencies, standard setters, and regulators.

To begin the process of reform, we first must understand how we got here. And what is clear is that Enron did not occur in a vacuum. That is not to say that the unparalleled prosperity and enormous productivity gains of the 1990s were as illusory as Enron's books. They were real and historic phenomena springing from the growth of the Internet, advances in microchip processing speed, and sound fiscal policy.

At the same time, some of the same technological advances that were driving the economy were also making investing easier, creating millions of new investors. With the intense focus the media brought on stock price, American companies took on an obsessive zeal to project greater earnings from year to year.

What then took hold was a culture of gamesmanship in which it was acceptable for corporations to bend the rules, tweak the numbers, and let obvious problems slide in order to meet Wall Street's desires and expectations.

Boosting share price and beating expectations took precedence over creating real value and real numbers. Analysts hyped the stock of companies with which their banks did business. Banks tied their business loans to the promise of future investment banking business. Auditors focused on selling profitable business services – such as consulting – rather than on exposing potential accounting irregularities. And, too often, boards of directors were more concerned with not offending management, than in protecting shareholders whose interests they have a duty to represent. Investors, for their part, suspended disbelief and went along for the ride.

Looking back, it becomes clear that what was once unthinkable in business has become ordinary. Gus Levy, the legendary head of Goldman Sachs, once said that his firm operated under the premise that it was "greedy, but long-term greedy." There is nothing wrong with making money – or wanting to make money. That's probably why many of us went into this business in the first place.

But at Enron and throughout much of corporate America, short-term gain has replaced long-term vision -- optics has replaced ethics.

Too often those who manage public companies, audit them, and serve on their boards of directors have forgotten that the opportunity to realize wealth in our capitalist system comes with a responsibility to the public from whose capital they are able to prosper. When the motivation to prop up stock prices overtakes the obligation to keep honest books, capital flows to the wrong companies and the very market system from which firms profit is fundamentally weakened.

Now, millions of investors are asking the same question that Enron vice president Sherron Watkins posed in her now-famous memo to Kenneth Lay: "For those of us who didn't get rich over the last few years, can we afford to stay?"

With more than $1 billion lost in Enron employee retirement accounts and billions more by individual investors, people are wondering: "Can I afford to risk my savings in the market?"

That crisis of faith didn't start with Enron. Over the past six years, investors have lost close to $200 billion through earnings restatements and audit failures. But the Enron crisis has combined with the implosion of high-flier tech stocks to call into question the strength of the fundamentals of our markets and market economy: transparency, accountability and trust. Restoring that confidence must be a high priority.

Thankfully, humiliation and embarrassment are still powerful forces for reform. Since the collapse of Enron, 12 congressional committees are pursuing inquiries, 32 bills have been introduced in Congress to address a variety of ills plaguing the financial system, the SEC has promised tough action, and the President last month introduced a 10-point plan on corporate governance and investor protection.

I will not take your time going over every one of these proposals. But I do want to address some urgent areas of reform – starting with the accounting profession.

Like no other, the accounting profession has been handed an invaluable, but fragile, franchise. From this federal mandate to certify financial statements, the profession has prospered greatly. But as an edict for the public good, this franchise is only as valuable as the public service it provides, and as fragile as the public confidence that gives it life.

It's well past time to recognize that the accounting profession's independence has been compromised. A recent study found that 307 of the companies that make up the S&P 500 spent $909 million in audit fees, and $2.65 billion for other services from those same firms. It doesn't take an MBA to realize that the incentive to compromise an audit has never been greater.

Last month, President Bush proposed prohibiting external auditors from carrying out services for a company "if the service compromises the independence of the audit."

This is a step in the right direction, but not a step far enough. It does nothing to prohibit the inherent conflict of interest that those auditing a company can still rely on that same company for other sources of revenue. Indeed, I fear that by proposing a watered-down version of the reforms his Treasury Secretary suggested, President Bush may have decreased the likelihood of substantive, legislative action.

The accounting profession itself has undertaken some changes to its rules. While I commend the accounting firms for voluntarily agreeing not to engage in certain services such as IT work and internal audit outsourcing, it is clear that there is a limit to how far they will go. I'm disappointed that the firms have remained silent about consulting on tax shelters or transactions, such as the kinds of Special Purpose Entities that Enron engaged in. This type of work only serves to help management get around the rules.

That is why we must consider totally divorcing consulting from firms' audit responsibilities, raise their auditing standards, and support a truly independent, self-regulatory organization that is not dependent on funding from their trade group – the AICPA.

This last initiative is particularly important. We must convert our insufficiently independent and overworked standard-setter – the FASB – into a totally independent, permanently endowed research and rule-making body. No longer must it seek funding, hat in hand, from the very companies to whom they provide standards and no longer must they be subject to political pressure applied by legislators motivated led by corporate contributions.

We also need to seriously consider requiring companies to change their audit firms every five to seven years to ensure that fresh and skeptical eyes are always looking at a company's numbers. In addition, we should consider prohibiting companies from hiring finance staff that have audited them. Cozy relationships must be ended.

I can tell you that these reforms won't be easy. Of all the groups that opposed me when I was SEC Chairman, none were more fierce, more competitive, and more aggressive than the accountants. Imagine an army of green eyeshades coming at you…

I have no doubt that the accounting profession once again will make its case. Already, the AICPA has retained high-powered lobbyists for a campaign against auditor independence reform, and the organization has begun e-mailing and contacting its members urging them to lobbying Congress as part of this effort.

I fear that the imminent failure of Arthur Andersen will empower the remaining Final Four to resist auditor independence reforms even more vigorously. Such an effort is irresponsible and short-sighted. AICPA is doing its members and its colleagues in the business community a disservice by resisting reform. If there is a lack of confidence in the reliability of financial information – about how performance is measured or what information is disclosed – investors will take their money elsewhere – to the detriment of us all.

Of course, auditor independence is only part of a larger overhaul that is needed.

We must also look at the independence of other gatekeepers of the financial system.

First, we must better expose analysts' conflicts of interest. For years, we've known that analysts' compensation is tied to their ability to bring in or support investment banking deals. Enron was known as a "deal machine," and unsurprisingly, in early December, with Enron trading at 75 cents a share, 12 of the 17 analysts who covered Enron rated the stock either a hold or buy.

Two years ago, I asked the New York Stock Exchange and the National Association of Securities Dealers to require investment banks and their analysts to disclose clearly all financial relationships with the companies they rate. Last month, we finally saw a response from the self-regulators. But it's not enough. Wall Street's major firms – not its trade group -- need to take immediate steps to reform how analysts are compensated. As long as analysts are paid based on banking deals they generate or work on, there will always be a cloud over what they say.

Second, company boards often fail to confront management with tough questions. To strengthen the credibility of boards of directors and audit committees, the SEC and the stock exchanges should bar consulting contracts and other entanglements as well as seductions such as corporate jet usage and support for a director's favorite philanthropy.

Most importantly, regulators must call for at least half of every corporate board to be independent under the most rigorous definition of that term. That means no lawyers, bankers, or consultants that have any relationship to that company can be considered independent members of that board.

Third, the reputation of our markets is rooted – in part – in the quality of their regulation. Despite the talent and hard work of the men and women of the SEC, the agency is severely understaffed and underfunded.

Last year, the SEC was able to review only 16 percent of annual corporate filings, half of the agency's goal. Driving this gap is that from 1991 to 2000, the number of financial filings has jumped 59 percent, but the number of investigators in that area has only increased 29 percent. Indeed, the SEC hadn't reviewed Enron's annual report since 1997.

This lack of resources also affects the SEC's ability to investigate failures like Enron. The numbers are shocking: between 1991 and 2000, the number of cases brought by the enforcement division increased by 65 percent, but the number of staff devoted to investigated only rose 16 percent.

Part of the SEC's problem is hiring and retaining personnel – especially when the professionals needed to do the agency's work can make considerable salaries with other employers.

Congress has passed legislation to fix the disparity in compensation between SEC employees and those at other financial regulatory agencies, but the Bush Administration has refused to fund it. Now more than ever, we can ill afford to allow inaction impede the quality of regulation, and as a direct result, the integrity of our markets.

Pay parity needs to be funded -- and needs to be funded now.

A strong SEC, uncompromised analysts, independent corporate boards, and a reinvigorated accounting profession are critical to the strength of our markets -- and of our economy as a whole. As the financial markets increasingly contribute to our economic health through the wealth effect, it becomes increasingly important that we keep our markets functioning at the highest level of integrity and with the highest level of confidence.

We are undergoing a far-reaching adjustment in our markets. As we have learned – some the hard way – the laws of economics and the fundamentals of corporate finance have not been suspended. Unfortunately, for many the learning of that lesson has only come about through real financial losses and real pain.

I believe that advances in technology have driven significant gains in productivity which in turn have fueled economic growth and prosperity. Despite our current hardships and the external demands placed on all of us as we fight a new war, we are still experiencing a transition to an economy fundamentally stronger than that of a generation ago – an economy fueled by an empowered, but challenged universe of stakeholders.

Managing this transition will not be easy. Throughout American history, there have been exuberant bull markets that were ended by events that precipitated a crash, which in turn, would create a lost generation of investors. It happened in 1873, and again in 1929.

Will it happen again now in the wake of the end of the strongest bull market ever? Will the bursting of the tech bubble plus the collapse of Enron and other irregularities lead the millions of Americans who joined the ranks of investors to make an about-face and walk out the door?

I hope not, and I believe it will not if we get the fundamentals right to sustain market confidence: transparency, disclosure, and accountability.

For no matter what changes we may undergo, these are the foundations upon which our market economy rests and the guideposts that make is possible for people to assess opportunities, calculate the risks, and invest their money to secure the future they dream of.

Thank you, and I would happy to take your questions, but only if you allow me to give the answers I want...